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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of

Allocation of Costs Associated with Local
Exchange Carrier Provision of Video
Programming Services

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

CC Docket No. 96-112

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Comments of BroadBand Technologies, Inc.

BroadBand Technologies, Inc., respectfully submits these comments in response to the Commission's *Notice of Proposed Rulemaking* in the above-captioned docket.^{1/} BroadBand Technologies believes that the cost allocation rules adopted in this proceeding will have a profound effect on the future evolution of the telecommunications network in the United States. Indeed, they will determine in large measure whether local exchange carriers (LECs) will deploy advanced integrated broadband networks in this country. Onerous cost allocation rules that penalize LECs economically if they opt to enter the video market by building integrated systems could cause LECs to forego the benefits of such systems and build physically separate video facilities instead.

^{1/}*Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services*, CC Docket No. 96-112, FCC No. 96-214, released May 10, 1996 (hereafter "Notice").

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Such an outcome would deprive consumers of the benefits of advanced broadband networks, including those supplied by BroadBand Technologies. These benefits include the economic efficiency gains achieved through the delivery of multiple services over a single platform, effective competition in the video services market and other former monopoly markets, and the availability of new interactive broadband services such as high-speed Internet access and health and educational services. Given these benefits, and Congress' directive to the Commission to "provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services,"^{2/} the Commission's cost allocation rules ideally should create incentives for the deployment of integrated networks. At a minimum, the rules should be neutral, allowing LECs to choose among network architectures on the basis of economic, commercial, and technological factors, rather than regulatory considerations.

The Telecommunications Act of 1996 eliminated the previous statutory prohibition on LECs providing video programming directly to their subscribers, replacing it with a regulatory framework intended to encourage LEC entry into the video market. Under the new law, a LEC wishing to enter the video programming market on a wireline basis may do so as a cable system operator or as an "open video system" operator.^{3/} The LEC also must decide whether to carry its video programming and regulated telephony services over a single integrated facility, or build a separate, stand-alone system to carry its video

^{2/} *Joint Explanatory Statement, Telecommunications Act of 1996 Conference Report*, S. Rep. 104-230 at 113 (Feb. 1, 1996).

^{3/} Telecommunications Act of 1996, Pub.L. No. 104-104, 101 Stat. 56 (1996) § 651(a).

programming and continue providing regulated telephony services over its existing narrowband telephone network.

Absent regulatory disincentives to do so, LECs should opt to build integrated systems, in order to achieve the economic efficiencies discussed above and ensure that their networks are capable of delivering advanced broadband services in the future. BroadBand Technologies was founded in 1988 on the conviction that switched digital broadband networks would emerge as the optimal platform for the delivery of telephone services, video programming, high-speed data services, and other broadband services. The migration toward integrated platforms is a major strategic objective in both the telecommunications and cable TV industries, and the Commission has sought in the past to encourage the deployment of these advanced infrastructures through such policies as the video dialtone rules^{4/} and the cable TV "going forward" rate regulations.^{5/} In enacting the Telecommunications Act, Congress clearly intended for the Commission to continue promoting the deployment of broadband infrastructure.

However, the progress toward integrated platforms will be halted if the cost allocation rules adopted in this proceeding create disincentives to deploy such systems. Broadband Technologies is concerned that some of the regulatory alternatives discussed in the *Notice* would have precisely that effect. Broadband Technologies urges the Commission

^{4/} *Telephone Company-Cable Television Cross-Ownership Rules, Section 63.54-63.58. Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd. 5781 (1992) at 5787.*

^{5/} *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking, 10 FCC Rcd. 1226 (1994).*

to bear in mind that the cost allocation rules it adopts in this proceeding will affect the LECs' network architecture choices. As the Commission itself notes, the allocation of joint and common costs such as loop plant is an "inevitably imperfect" exercise.^{6/} If the rules adopted in this proceeding result in an overallocation of these costs to the LECs' video programming and other unregulated activities, the LECs will simply choose not to build integrated systems. Similarly, with respect to LECs subject to price cap regulation, if the Commission asks whether it should treat the proposed reallocation of joint and common costs to unregulated activities as "exogenous" when a carrier builds a broadband network, and require the price cap LECs to reduce their price cap indices accordingly.^{7/} If the Commission does this, the price cap LECs also are likely to decide not to build integrated systems.

LECs already will bear significant costs to upgrade their networks in order to enter the video programming market, in which they will compete with entrenched cable TV operators and with other programming providers. If, in addition, they are required to pay an "up-front" penalty in the form of rate reduction for their regulated services, most, if not all, LECs will decide to avoid these burdens by simply using physically separate wireless or wireline video distribution facilities. Clearly, such an outcome would disserve the public interest, by denying consumers both the benefits of an advanced integrated broadband network infrastructure, and the prospect of lower rates for both telephone and video services made possible by the economic efficiencies of integrated delivery.

^{6/} Notice at ¶ 23.

^{7/} Notice at ¶ 60.

The Commission should also bear in mind that the LECs' primary competitors, cable TV operators, also are planning to upgrade their networks in order to deliver telephone and video services on an integrated basis. Cable TV operators are not subject to cost allocation rules comparable to Part 64. They will not be required to reallocate the common costs of their networks to reflect joint use for telephone and video service, nor will they be obliged to reduce their cable TV service rates to reflect such a reallocation. The LECs should not be put at a regulatory disadvantage relative to cable TV operators, just as the competitive market created by the Telecommunications Act begins to take hold.

The Commission's primary purpose in this proceeding is to ensure that costs the LECs incur to provide unregulated services over integrated systems will be recovered from the LECs' "captive" telephone service customers. The entry of cable TV operators and other competitors into the local exchange services market will create a market-based solution to this danger. Once the LECs face effective competition for their regulated services, this will eliminate the remaining vestiges of their ability to cross-subsidize competitive services out of regulated revenues. Given that any cost allocation rules are "inevitably imperfect" and, thus, result in economic distortions, the Commission should avoid adopting complex and burdensome rules in this proceeding to address transitional issues that will be resolved in the near future through market forces.

As a general matter, BroadBand Technologies urges the Commission to adopt rules that are consistent with the Telecommunications Act's deregulatory thrust and further the new law's goals of promoting competition and advanced networks. Given the inherent difficulty in allocating non-traffic sensitive joint and common costs in integrated networks,

the Commission should err on the side of rules that promote integrated platforms, knowing that market forces will, in short order, correct any misallocations.

I. Loop Plant And Switching Costs Should Not Be Subject To A Mandated Allocation Factor

In the *Notice*, the Commission proposes to adopt a fixed factor for allocating loop plant common costs between regulated and unregulated services.^{8/} The Commission also asks whether a fixed allocation or usage-based allocation should be used to allocate the cost of switching equipment used to provide telephony and video programming and other unregulated services.^{9/} While BroadBand Technologies acknowledges that a single fixed allocator has the virtue of simplicity and ease of application, we respectfully urge the Commission not to adopt this approach.

One of the Commission's stated goals in this proceeding is to adopt cost allocation rules that are neutral with respect to different integrated network technologies.^{10/} Fixed allocators for loop plant and switching would not meet this standard. A single allocator would result in an allocation favoring one technology or another, depending, for instance, on the degree of integration of the system (i.e. the extent to which the facilities are in fact used jointly to provide regulated and unregulated services). Even granting that the allocation of fixed costs is an inherently arbitrary exercise, the proper allocation clearly

^{8/} *Notice* at ¶ 40.

^{9/} *Notice* at ¶¶ 43-44.

^{10/} *Notice* at ¶ 25.

would vary depending on the network architecture used and the services being provided. A uniform allocation factor would, therefore, result in distortions as great as those that prompted the Commission's tentative conclusion to reject usage-based allocations for loop plant.^{11/}

With respect to switching costs, BroadBand Technologies' integrated network architecture highlights the drawbacks of using a fixed allocator for such costs. In BroadBand Technologies' Fiber Loop Access (FLX) system, certain switching components are used exclusively for the delivery of unregulated services, while other components are used exclusively for traditional regulated telephone services.^{12/} A fixed allocator, under which those costs would be split arbitrarily between regulated and unregulated services, would not appear to be appropriate in the case of the FLX architecture. Indeed, these switching costs can, and should, be allocated pursuant to the Commission's existing Part 64 process.

Instead of adopting fixed allocators for loop plant costs, the Commission should consider adopting guidelines for the allocation of such costs and direct the LECs to propose allocations that accurately reflect the particular networks and service configurations they intend to offer. The guidelines would be similar to those the Commission adopted in the video dialtone proceeding, where it required that a reasonable proportion of common costs be allocated to video dialtone service.^{13/}

^{11/} Notice at ¶ 33.

^{12/} *Amendment to the Bell Atlantic Telephone Companies Tariff FCC No. 10*, Transmittal No. 741, Letter of J. Richard Jones, Executive Vice President, Broadband Technologies, Inc. (filed March 6, 1995).

^{13/} *In the Matter of Telephone Company-Cable Television Cross-Ownership Rules*, Section 63.54-63.58, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244 (1996) at 247-248.

Should the Commission decide, nonetheless, to adopt a fixed allocator for loop loop plant, a 50% allocator would clearly result, with respect to the FLX architecture, in a significant overallocation of costs to unregulated services. Bell Atlantic is using the FLX system in Dover Township, New Jersey. In that joint use installation, Bell Atlantic determined that 28% of certain common costs should be allocated to unregulated services. That evidence indicates that an allocator of 50% would strongly discourage LECs from deploying integrated networks. Again, BroadBand Technologies stresses that whatever cost allocation rules the Commission adopts, LECs will retain the option to build non-integrated systems instead. If the cost allocation "penalty" for using integrated systems is excessive, such systems simply will not be built.

II. New Cost Allocation Rules Are Not Needed To Protect Price Cap LECs' Customers

The Commission requests comments on the application of the proposed cost allocation rules to price cap carriers.^{14/} BroadBand Technologies believes that the Commission's price cap and joint and common cost rules protect ratepayers from any risks of paying through regulated rates for future investment in integrated networks by LECs. This is particularly the case with those LECs that have selected the no-sharing option under the Commission's interim price cap rules. These LECs have no incentive and no ability to shift costs between regulated and nonregulated services in order to recover these costs through unregulated rates. Their rates are determined by the price cap formula. There is, therefore,

^{14/} Notice at ¶¶ 58-63.

no need for the Commission to impose any of the proposed cost allocation rules on these LECs. Even for the few LECs that have selected a sharing option, any incentives to shift costs in order to manipulate the sharing obligations are minimal.

To the extent that the deployment of integrated broadband systems result in dramatic increases in the price cap LECs' productivity, these improvements should be reflected in the productivity offset element of the price cap formula. These risky but potentially valuable investments are precisely the types of activities price caps were designed to stimulate. The Commission is currently considering proposals to modify the basis on which the productivity offset is calculated, including the use of a rolling average approach. This approach would fully reflect in the LECs' rates the productivity gains achieved through the use of integrated networks. It would do so by affecting the productivity offset. Should the Commission adopt this approach in its permanent price cap rules, it would fully meet its objective of ensuring that the price cap LECs' ratepayers receive a significant share of the benefits from the use of integrated networks.

Finally, if the Commission continues to require the price cap LECs to allocate their costs, it should not treat any reallocation resulting from the rules adopted in this proceeding as "exogenous," thus triggering a reduction in the LECs's price cap indices. The Commission's rules governing exogenous costs do not require such an interpretation. Exogenous treatment is only meant to apply to factors beyond the control of telephone companies. Network architecture decisions obviously do not fall into this category. Further, the purpose of the price cap rules is to create incentives for the LECs to innovate and improve their productivity. To take away the gains they achieve from the major innovation (and risk) of upgrading their networks to broadband capability would violate the premise and

purpose of price caps. On a practical level, moreover, requiring the LECs to reduce their price cap indices (and, hence, their rates) as a pre-condition for building integrated networks would simply prompt them to abandon their plans for such networks. The result would be the construction of stand-alone video networks. Consumers would continue to be served by separate, traditional narrowband telephone and one-way video networks, neither of which would approach the advanced broadband network Congress intended and normal market forces would dictate. The Commission should not allow its regulations to cause such a sub-optimal outcome.

III. CONCLUSION

For the reasons discussed above, BroadBand Technologies respectfully urges the Commission to adopt a flexible approach cost allocation that encourages the economically efficient deployment of integrated broadband networks. Such an approach will serve the public interest by ensuring the development of a state-of-the-art telecommunications network in the United States.

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May 31, 1996

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CERTIFICATE OF FILING AND SERVICE

I, Mary-Helen Dove, hereby certify that an original and nine copies of the foregoing Comments of BroadBand Technologies, Inc., in CC Docket No. 96-112 were deposited for filing with the Office of the Secretary, Federal Communications Commission, Washington, D.C. 20554, this 31st day of May, 1996.

I further certify that a true copy of the Comments of BroadBand Technologies, Inc., in CC Docket No. 96-112 was served by same-day courier service on each of the parties listed below this 31st day of April, 1996.

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